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SUBJECT: Taiwan Begins Tax Overhaul with an AMT System

Ref: Taipei 3298

1. (SBU) Summary: On December 9, Taiwan passed a tax reform bill establishing an alternative minimum tax mechanism (AMT). The AMT will affect only about 0.9% of individual taxpayers and 0.3% of business firms, but will have a disproportionate impact on high-tech industries because of the tax incentives they currently enjoy. Business leaders warn that the AMT may prompt further industrial relocation offshore and emigration of high-income people. End summary.

First New Tax in 20 Years

2. (SBU) On December 9, Taiwan's Legislative Yuan passed the Alternative Minimum Tax Law. The AMT will become the first new tax since 1985 (when Taiwan adopted the 5% business transaction tax, VAT). The AMT will affect only businesses whose annual income exceeds NT\$2 million (about US\$60,000) and individuals whose annual income exceeds NT\$6 million (about US\$ 180,000). The AMT tax rate will be 20% for individuals and 10-12% for businesses and will be applied to income earned in 2006. Taxpayers must start filing the AMT tax in May 2007. According to the new law, offshore income earned by individuals will be subject to the AMT starting in 2009. The Ministry of Finance (MOF) is authorized to delay the implementation date for offshore income to 2010.

Effects

3. (SBU) The MOF estimates the AMT will have very limited effect on most taxpayers. Investment projects now enjoying a five-year tax holiday and new projects already approved by the Ministry of Economic Affairs to receive a five-year tax holiday will be exempt from the AMT during their tax holiday period. Projects entitled to tax credits, however, will be subject to the AMT. The AMT will not apply to capital gains by foreign portfolio investors in Taiwan. The MOF estimates that some 6,000 business firms will be affected by the AMT, or 0.9% of total business firms in the MOF's tax payment records. The MOF estimates that AMT tax revenue from businesses will be NT\$12.8 billion (or US\$0.38 billion) or 5% of total corporate income tax in 2004.

4. (SBU) The Economic Daily News (EDN) estimates that some 16,000 individuals, or only 0.3% of total taxpayers, will be subject to the AMT. The MOF said that it could not estimate the expected AMT tax revenue from individuals because of insufficient data on non-cash charitable donations and life insurance premiums (currently tax exempt items that will be included in the AMT calculations). However, it is very clear that high-tech industries and employees of high-tech companies will suffer the biggest hit because they currently enjoy significant tax benefits. On December 15, representatives from high-tech companies told AIT that their companies and employees currently pay less than 5% of income in taxes. Estimates vary, but firms and individuals are likely to be paying twice that rate under the new AMT system.

Business Leaders Complain

5. (SBU) Passage of the AMT has prompted business complaints. Theodore Huang, Chairman of the National Federation of Industry and Commerce, and Hsu Sheng-hsiung, Chairman of the Taiwan Electrical and Electronic Manufacturers' Association, have made public remarks condemning the legislation. General Chamber of Commerce Chairman Wang Ling-ning warned the AMT could further dampen

domestic investment. Hsu suggested that both the Executive Yuan and the Legislative Yuan should be held responsible for the negative impact on Taiwan's economy. He stated that the AMT would encourage investors to move offshore and noted the contrast to Singapore's efforts to attract investors with a 5-10 year tax holiday. Hsu said a 10% AMT exceeded the level tolerable to the business community and urged the government to phase out the 10% tax on retained earnings to reduce the tax burden on businesses.

16. (SBU) Yeh Kong-liang, Chairman of Fubon Securities Company, said that the AMT could cut profits of listed companies, and could erode 10% of high-tech firms' profits, which, in turn, would lead to a decline in high-tech share prices. Yeh noted that the AMT could force high-tech firms to relocate offshore or reduce their profitability and wages for employees.

17. (SBU) Chairman Yeh predicted the AMT would put pressure on stock prices to fall every September and October, when high-tech firms usually distribute dividends to their employees. Yeh explained that the AMT would apply to the market price of the stock the day after the issuance of the dividend. Consequently, high-tech employees are expected to immediately sell the dividend stocks to avoid paying the AMT, resulting in a decline in share prices.

Private Complaints More on Style than Substance

18. (SBU) High-tech companies privately told AIT December 15 that while they are generally opposed to any new taxation measures the new AMT system does not pose an undue burden in terms of their competitive position. Further, the firms generally acknowledge that the privileged tax position for their firms and employees imposes a burden on other Taiwan taxpayers. However, the firms did object to being singled out by political and government leaders as unfairly benefiting from the existing system. They would have wished for the AMT regime to simply be touted as a needed tax reform to more equally share the tax burden without pointing the finger at any one industry.

Other Analysts Less Pessimistic

18. (SBU) Other analysts expect the financial impact of the legislation will be slight, less than what had been expected. CLSA (the Asian investment banking arm of Credit Agricole, the world's fifth largest bank) estimates the hit will only be about 2.4% of high-tech firms' earnings. According to Yang Wen-chien of Yuanta Core Pacific Investment Research the AMT will have little impact on traditional industries, which pay an average of 16% tax, much higher than the 3-5% paid by high-tech firms. Taxes paid by iron & steel companies averaged 20%.

COMMENT

19. (SBU) AIT believes the AMT will not have as much impact as some business leaders fear because Taiwan's current tax burden is a relatively low 12-13% of GNP and existing tax holidays for high-tech investments will be preserved. Senior executives from some of Taiwan's leading information technology (IT) companies have told us that they have long supported expanding taxation to high-tech firms as a matter of social equity. They believe that Taiwan's industry is well able to absorb what they perceive to be a fairly modest tax increase. The AMT will be a starting point for Taiwan to levy tax on offshore income and a starting point for a capital gains tax on securities trading (AMT will not apply to trading of listed stocks but will cover trading of unlisted stocks.) A recent Gallup poll for CLSA showed broad support for the AMT, which is perceived as a system to share more equitably the tax burden. The measure will also address the growing government budget deficit.

10. (SBU) Whether or not Taiwan will be able to tax income from overseas is debatable. Taiwan has tax treaties with only 15 countries, which do not include its major trading partners, the United States, Japan, and China. Taiwan authorities would be largely dependent on data supplied by the taxpayers regarding any overseas income.

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